



Memorandum

*Regional Inspector General
Pretoria*

DATE: May 4, 2000

TO: Regional Director, USAID/REDSO/ESA, Mr. Donald R. Mackenzie

FROM: RIG/Pretoria, Joseph Farinella

SUBJECT: Audit of USAID/REDSO/ESA's Implementation of the Federal Managers' Financial Integrity Act, Report No. 4-623-00-006-P

This memorandum is our report on the subject audit. The report contains two recommendations. We have considered your comments on the draft report and have included them in their entirety in Appendix II.

I appreciate the cooperation and courtesies extended to my staff during the audit.

Background

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) establishes requirements for management accountability and controls for Federal agencies. This law encompasses program, operational, and administrative areas as well as accounting and financial management. Under the authority of the FMFIA, the Office of Management and Budget (OMB) issued Circular No. A-123, Management Accountability and Control, to provide detailed guidance for assigning Federal managers the responsibility for designing management structures to help ensure accountability and include appropriate cost-effective controls.

OMB Circular No. A-123, states that management controls are the organization policies and procedures used to reasonably ensure that: (1) programs achieve their intended results; (2) resources are used consistent with agency mission; (3) programs and resources are protected from waste, fraud, and mismanagement; (4) laws and regulations are followed; and (5) reliable and timely information is obtained, maintained, reported and used for decision making. The Circular provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on management controls.

In addition, the FMFIA required the U. S. General Accounting Office (GAO) to issue standards for internal control in the government. Control activities are the policies, procedures, techniques, and mechanisms that enforce management directives. Certain categories of control activities are common to all agencies and include, among other things, appropriate documentation, accurate and timely recording of transactions and events, and the proper execution of transaction and events.

Within USAID, the Agency issued Automated Directives System (ADS) Chapter 596, Management Accountability and Control, which provides USAID's policy and procedures for establishing, assessing, correcting, and reporting on management controls under FMFIA and OMB Circular No. A-123. Additional guidance for assessing the adequacy of management controls and annual instructions for reporting the status of management controls is periodically provided by USAID's Bureau for Management, Office of Management, Planning and Innovation (M/MPI).

Audit Objectives

The Office of the Regional Inspector General, Pretoria (RIG/Pretoria), audited USAID/REDSO/ESA to answer the following audit objectives:

- **Has USAID/REDSO/ESA established management controls and periodically assessed these controls to identify deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**
- **Has USAID/REDSO/ESA reported material weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**
- **Has USAID/REDSO/ESA taken timely and effective action to correct identified management control deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?**

Appendix I includes a discussion of the scope and methodology for this audit

Audit Findings

Has USAID/REDSO/ESA established management controls and periodically assessed these controls to identify deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

USAID/REDSO/ESA has established management controls and periodically assessed these controls to identify deficiencies in accordance with the FMFIA and related regulations and guidance. However, we believe the Mission could further strengthen its management controls, and its review of those controls, by performing a formal and systematic risk assessment of its operations and programs. These areas are discussed below.

Management Controls Established and Assessed

FMFIA and OMB Circular No. A-123 provide guidance for use by Federal Agencies and managers to, among other things, establish management controls and to periodically assess the adequacy of those controls. Further, ADS Chapter 596, "Management Accountability and Control" instructs Missions and cognizant managers to: (1) appoint a Management Control Official (MCO) to oversee and coordinate management accountability and control issues within the Mission; (2) ensure that appropriate and cost-effective management controls are established; (3) continuously perform management control assessments in accordance with instructions issued by USAID's Bureau for Management's Office of Management Planning and Innovation (M/MPI); and (4) establish a Management Control Review Committee (MCRC) to assess and monitor deficiencies in management controls.

Moreover, M/MPI provides annual guidance to Missions for conducting FMFIA reviews. In conducting reviews, Missions are instructed to use existing sources of information to supplement management's judgment in assessing the adequacy of management controls, including: 1) management knowledge gained from daily operation of Agency programs and systems; 2) management reviews; 3) Office of Inspector General and General Accounting Office reports; and 4) program evaluations.

Missions are also instructed to review USAID's ADS in determining Mission compliance with policies and essential procedures. M/MPI provides a Management Control Checklist to assist in conducting the reviews. The FY 1998 Checklist contained 163 control techniques extracted from the ADS.

In implementing the ADS, USAID/REDSO/ESA appointed the USAID/REDSO/ESA Director as the MCO to oversee and coordinate management accountability and control issues within the Mission. The Mission also established a MCRC comprised of office managers and headed by the Deputy Mission Director to provide oversight of its management control process.

USAID/REDSO/ESA took an organized approach in completing the FY 1998 FMFIA assessment. The Controller's Office coordinated the review among the office managers or Strategic Objective Team Leaders (SO team leaders) and cognizant financial analysts, prepared a timetable for conducting the review and specified deadlines for the submission of the review results. A financial analyst within the Controller's Office formally transmitted the M/MPI checklist containing 163 control techniques along with instructions to cognizant offices within the Mission.

Upon receipt of the checklist, each office or SO team leader and cognizant staff determined whether the controls in their areas were satisfactory and noted any deficiencies. The teams then summarized their evaluation on a control technique worksheet and submitted it to a Controller Office's financial analyst assigned as the coordinator. After receiving this evaluation, the financial analyst reviewed and validated both the ratings of controls and the

conclusions reached. These conclusions were subsequently reviewed by the Controller and Mission's MCRC, who determined what actions should be taken on deficiencies and whether they should be considered material weaknesses. As required, USAID/REDSO/ESA reported its material weaknesses. The following table highlights the areas addressed by these control techniques.

CONTROL TECHNIQUES	
CATEGORY	NUMBER
Program Assistance	37
Organization Management	7
Administrative Management	40
Financial Management	44
Acquisition and Assistance	27
Audit Management Resolution Program	5
Other	3
TOTAL	163

Risk Assessments Would Further Strengthen the Mission's FMFIA Process

USAID/REDSO/ESA has established the management controls outlined in USAID's ADS and, in some cases, has supplemented those controls. However, we believe formal and systematic risk assessment of its operations and programs would strengthen the process.

Recommendation No. 1: We recommend that USAID/REDSO/ESA determine whether a formal and systematic risk assessment would strengthen the efficiency of its FMFIA review.

GAO Standards for Internal Control in the Federal Government state that internal controls should provide for an assessment of the risks USAID faces from both external and internal sources.

Most of the Mission's assessments of management controls were conducted as a part of its Audits and Audits Resolution Program. Consequently, the Mission's MCRC agenda focused on FMFIA issues, audit recommendation follow up, audits in progress, and planned audit management and resolution. While some of the USAID/REDSO/ESA SO teams conducted an ongoing monitoring program other SO teams within the Mission routinely performed management reviews by conducting site visits and field trips whose findings or results were documented. For example in FY 98, few of USAID/REDSO/ESA's policies and procedures were included in its Mission orders as it has just instituted a Mission Order system independent of USAID/Kenya.

The benefits of risk assessment are two-fold. First, by conducting risk assessments, Mission managers can ensure that they have established management controls that are appropriate to their unique situation. Second, by identifying the level of risk in operations and programs, senior Mission management can focus more resources on high risk areas and less resources on low risk areas, thereby increasing its efficiency and effectiveness.

During our audit, we found that the Mission did not perform formal risk assessments in FY 1998. Mission officials told us they were not aware of the benefits of conducting risk assessments. Many never formally participated in or have been trained in conducting these types of reviews. Although the Mission managers told us they informally discussed vulnerable operations and processes, those discussions were not documented or recorded for follow-up. Therefore, the Mission management may not be informed regarding its susceptibility to high risks before a situation becomes a cause of major concern.

Has USAID/REDSO/ESA reported material weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

USAID/REDSO/ESA performed an evaluation of its system of internal accounting and administrative controls in FY 1998 and identified two material weaknesses ---- (1) Contract Grant Closeouts, and (2) the lack of Operating Expense funds. The Mission reported those weaknesses in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance in October 1998.

The Office of Management and Budget (OMB) Circular No. A-123 requires that a management control deficiency should be reported if it is or should be of interest to the next level of management. This allows the chain of command structure to determine the relative importance of each deficiency. In this regard, USAID's ADS Chapter 596 and M/MPI's FY 1998 instructions required Missions to provide a FMFIA certification to the cognizant Assistant Administrator with a copy to M/MPI, on the overall adequacy and effectiveness of management controls. This certification should identify management control deficiencies determined to be material weaknesses, including those that are not correctable within the Mission's authority and resources.

One of the two material weaknesses reported by USAID/REDSO/ESA was not correctable within the Mission's authority and resources. In the aftermath of the U. S. Embassy bombing in Nairobi, increased security was necessary for residences and offices. This security was not funded in the OE budget. The second material weakness, contract closeouts, was reported and corrected in FY 1997. This weakness was resubmitted because the individual hired to fulfill the position resigned mid-year.

Has USAID/REDSO/ESA taken timely and effective action to correct identified management control deficiencies in accordance with the Federal Managers' Financial Integrity Act and related regulations and guidance?

OMB Circular No. A-123 and USAID's ADS Chapter 596 require Agency managers to take timely and effective action to correct deficiencies identified. USAID/REDSO/ESA took the appropriate action in correcting deficiencies identified in its FY 1998 FMFIA review. The Mission closed the two deficiencies noted in FY 1997's FMFIA review. However, the Mission's MCRC files did not contain sufficient supporting documentation of the closure of these two material weaknesses.

Recommendation No. 2: We recommend that USAID/REDSO/ESA establish a procedure to formally document the Management Control and Review Committee's and other meetings during the FMFIA review.

In its FY 1998 review, the Mission identified two deficiencies, including one deficiency repeated from the 1997 review. In following up with Mission officials, we noted that the Mission had taken some steps to correct the deficiencies. The Mission did not maintain documentation, i.e., minutes of MCRC meetings, to show that the MCRC reviewed and approved the corrective actions taken. Such documentation would show that the MCRC reviewed the actions taken on the deficiencies and determined that the actions were sufficient to correct the deficiencies.

The lack of documentation when corrective actions are completed makes it difficult to determine if a corrective action was actually completed and whether the MCRC agreed to the closure of the material weakness. With a formalized tracking system by which to monitor the correction of an identified control deficiency, management would be better able to review as well as report on progress toward closure.

Although USAID/REDSO/ESA conducted MCRC meetings to discuss outstanding deficiencies, there were no minutes of the meetings. Therefore, we were unable to verify the corrective actions taken and MCRC approval of completed actions.

Management Comments and Our Evaluation

Recommendation No. 1 states: "We recommend that USAID/REDSO/ESA determine whether a formal and systematic risk assessment would strengthen the efficiency of its FMFIA review."

The Mission concurred with the recommendation and agreed that a more formalized assessment of risk would strengthen the FMFIA process. The Mission noted that the nature of such a formalized assessment and its implementation cannot be clearly specified at this time and that it will seek guidance from AID/W on this matter.

In addition, the Mission also stated, in its comments, that most staff have no training in conducting risk assessments or a clear understanding of what a "formal risk assessment" might entail. Without guidance, training or assistance, the Mission is not in a position to conduct a comprehensive risk assessment. The Mission stated that it will look to AID/W for guidance on this matter.

The Mission also stated that its managers indicated to the auditors that vulnerable operations and process were discussed during the FMFIA review process which is an indication the Mission is currently making efforts to consider risk factors in its review process.

Based on the foregoing, a management decision has been reached on Recommendation No. 1. Please notify M/MPI when final action is complete.

Recommendation No. 2 states: “We recommend that USAID/REDSO/ESA establish a procedure to formally document the Management Control and Review Committee’s and other meetings during the FMFIA review.”

The Mission concurred and stated that formal minutes of MCRC and other meetings associated with FMFIA review are now being maintained.

Based on the foregoing, a management decision has been reached on Recommendation No. 2. Please notify M/MPI when final action is complete.

The complete text of management comments is included in Appendix II.

SCOPE AND METHODOLOGY

We audited USAID/REDSO/ESA's implementation of the Federal Manager's Financial Integrity Act (FMFIA). The audit was performed in accordance with generally accepted government auditing standards and was conducted from October 25 through November 19, 1999 at USAID/REDSO/ESA in Nairobi.

We reviewed the Mission's FY 1998 FMFIA assessment and deficiencies noted in its FY 1997 assessment. We did not design our audit to identify material weaknesses that were not reported by the Mission; however, if any previously unreported weaknesses came to our attention during the audit, we included these in our audit report.

The audit work included reviewing the Mission's system for establishing, assessing, reporting and correcting management controls. To accomplish the audit objectives, we reviewed the Federal Manager's Financial Integrity Act, Office of Management and Budget Circular No. A-123, General Accounting Office's (GAO) "Standards for Internal Control in the Federal Government," and USAID's Automated Directives System (ADS) Chapter 596 on Management Accountability and Control. In addition, we reviewed USAID's guidance for assessing the adequacy of management controls and annual instructions for reporting on the status of these controls, as well as other ADS Chapters relating to Agency policies and essential procedures, and recent Office of Inspector General audit reports performed at USAID/REDSO/ESA.

We developed and used a questionnaire to obtain information from the Mission's Management Control Official, Management Control Review Committee members and operating unit managers. To supplement this information, we also reviewed available documentation from FY's 1997 and 1998 FMFIA reviews, including management control deficiencies identified and management action plans for correcting those deficiencies. We reviewed the Mission's FMFIA Certifications to the AA/AFR on the overall adequacy and effectiveness of management controls, the material weaknesses identified, and obtained information on the status of the material weaknesses identified in the Fiscal Years 1997 and 1998 reviews.

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MEMORANDUM

DATE: April 25, 2000

FROM: Donald R. Mackenzie, Regional Director REDSO/ESA 

TO: Joseph Farinella, RIG/Pretoria

SUBJECT: Audit of USAID/REDSO/ESA's Implementation of the Federal Managers' Financial Integrity Act, Report No. X-XXX-00-XX-P

I have reviewed the RIG draft of the subject audit report, and submit the following comments regarding the findings and recommendations.

The Mission notes that the findings of the audit are generally positive. The audit found that REDSO/ESA had established and assessed management controls in accordance with the FMFIA and related regulations and guidance, and reported and closed material weaknesses. The recommendations are suggestions for improvements in REDSO's systems.

One principal focus of the audit was the benefits of "risk assessment". The Mission agrees with the premise that an assessment of risk is beneficial in establishing and reviewing internal controls. Risk assessment can assist in focusing resources on high-risk areas, and minimize effort spent on low-risk areas. The result should be a more efficient process. The Mission would like to highlight the two statements in the draft audit. First most Mission staff have no training in conducting risk assessments. It would be safe to say that most have no clear understanding of what a "formal risk assessment" might entail. Without guidance, training or assistance the Mission is not in a position to conduct a comprehensive risk assessment. The second audit statement we would like to highlight is that Mission managers indicated to the auditors that vulnerable operations and processes were discussed during the FMFIA review process. Although these discussions were not formally documented it is an indication that the Mission is currently making efforts to consider risk factors in its review process. Current efforts

at factoring risk into the review process can be formalized and documented. Again, however beneficial risk assessments may be, the Mission is not in a position to more conduct more meaningful assessments without assistance from outside the Mission.

Recommendation No. 1: We recommend that USAID/REDSO/ESA determine whether a formal and systematic risk assessment would strengthen the efficiency of its FMFIA process.

The Mission concurs in this recommendation. We agree that a more formalized assessment of risk would strengthen our FMFIA process, and request that this recommendation be resolved and closed on issuance. However we note that the nature of such a formalized process, and its implementation cannot be clearly specified at this time. The Mission will look for guidance from AID/W on this matter.

The second principal area of audit concern was lack of documentation of MCRC meetings. The Mission acknowledges this problem with regards to the FMFIA review for FY 1998. The FY98 review was conducted less than three months after the bombing of the US Embassy in Nairobi. The Director of the Regional Financial Management Center (RFMC) who coordinated the FMFIA review, and the REDSO Deputy Director who chaired the MCRC meetings were both newly arrived. The FSN Financial Analyst who managed the data collection process was newly assigned to the effort. Amid all the change and confusion preparation of formal minutes of the MCRC meetings simply fell through the cracks. MCRC meetings for the FY 1999 review were properly documented. The Mission will continue to assure that proper documentation will be maintained in the future.

Recommendation No. 2: We recommend that USAID/REDSO/ESA establish a procedure to formally document the Management Control and Review Committee's and other meetings during the FMFIA review.

The Mission concurs in this recommendation. Formal minutes of meetings of the MCRC and other meetings associated with the FMFIA review are now being maintained. We request resolution and closure of this recommendation on issuance of the audit.